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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 663.

JOHN A. SNYDER, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

On a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

REPLY BRIEF FOR PETITIONER.

Petitioner, with respondent's consent, submits the brief filed in support of the petition as petitioner's brief, the necessary changes in the page references to the record having been made.

At page 5 of the Government's brief, in the instant case, its brief in the *Rankin* case, in which its argument is made, is adopted. Similarly, this petitioner adopts the respondent's brief in the *Rankin* case with the reservation that petitioner submits that, in the instant case, petitioner's intention to sell the last acquired stock first is as fully established as in that case.

SUMMARY OF ARGUMENT.

FIRST. THE GOVERNMENT CONCEDES THAT PETITIONER INTENDED TO SELL THE LAST ACQUIRED SHARES FIRST, BUT CONTENDS THAT THIS INTENTION IS IMMATERIAL.

SECOND. PETITIONER'S INTENTION TO SELL THE LAST ACQUIRED SHARES IS SHOWN BY THE RECORD TO HAVE BEEN CARRIED INTO EFFECT.

THIRD. THE RESPONDENT HAS NOT CORRECTLY STATED PETITIONER'S POSITION.

FOURTH. SECTIONS 111, 112 AND 113 OF THE REVENUE ACT OF 1928, ON WHICH RESPONDENT RELIES, ARE INAPPLICABLE TO CURRENT TRANSACTIONS OF PURCHASE AND SALE ON MARGIN DURING THE TAX YEAR SUCH AS HERE INVOLVED.

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SEVENTH. SHOULD IT BE HELD THAT THE REGULATION IS VALID AND ENFORCEABLE WITH RESPECT TO THE TRANSACTIONS HERE INVOLVED AND THAT IT IS NOT AT AN END UPON THE EVIDENCE, IT SHOULD BE LIMITED, IN ITS APPLICATION TO THE PURCHASES IN THE TAX YEAR AND NOT APPLIED TO PURCHASES IN PRIOR YEARS.

FIRST.

THE GOVERNMENT CONCEDES THAT PETITIONER INTENDED TO SELL THE LAST ACQUIRED SHARES FIRST, BUT CONTENDS THAT THIS INTENTION IS IMMATERIAL.

At page 5 of respondent's brief in the instant case it is stated:

> "The taxpayer intended to sell the last shares acquired by him."

At page 12 (Rankin brief) the Government contends:

> "We submit the taxpayer's intention is without bearing on the question here. It is apparent from the language of the regulation that actual identification and not mere intent is the controlling factor."

At page 15 (Ibid.) it is said:

> "Since the broker cannot identify, it is not apparent how the communication of the taxpayer's intention to the broker can add anything to the intention itself."

And at page 28 (Ibid.):

> "The real burden of taxpayer's complaint is not that he has been deprived of an opportunity to make a defense, but rather that he has no defense to offer, which in turn is due, not to the assailed regulation, but to the nature of the transaction in which he voluntarily engaged."

This contention clearly shows that the regulation is arbitrary and oppressive. In the instant case the tax due, by application of the regulation has been increased from $1897.77 (petitioner's brief, p. 30, Appx. B) to $38,961.22. (R. 18.) The net taxable income in the tax year of about $39,682.10, has been increased to $197,495.85. (Ibid.)

SECOND.

PETITIONER'S INTENTION TO SELL THE LAST ACQUIRED SHARES FIRST IS SHOWN BY THE RECORD TO HAVE BEEN CARRIED INTO EFFECT.

It is pointed out in petitioner's brief (p. 24) that in the instant case the only evidence which could be available was introduced, namely; (1) *his intention* (a) to accumulate as many shares of U. G. I. as he could; (b) to sell the shares the purchase of which had, on a fall in daily quotations, impaired his margin; (c) to buy back an equal or greater number of shares, when in his judgment, the market condition was favorable; (2) *the carrying out of this intention by action* as shown by the Statement of Evidence (R. 31-32) the schedules of purchases and sales (R. 18-21) and the analysis of the same (Appendix A, to petitioner's brief, pp. 26-29).

This analysis shows clearly that whenever petitioner sold shares he promptly, within a few days or weeks, bought back an equal or greater number. Thus, between April 2d and 30th, he bought 600 shares in 6 lots of 100 each. May 3d-7th he bought 600 more in 100 share lots. May *10th* he sold 1000 shares at a substantial profit over the purchases in April and May and on May *14th* he bought back 500 shares. May 18-23, on a falling market he *sold 500* shares and June 14-18 *bought back 800* shares on a rising market. (R. 18-19; brief, p. 26) The other transactions were similar (R. 18-21; brief, pp. 26-29).

Thus petitioner's intention to sell was supported by his acts. He *intended* to sell the last acquired shares. He usually *sold* shares within a few days after acquiring them *on a falling market* (R. 18-23 column of quotations "4t" 133 3/8, 139, etc., etc.). In a few instances he realized a "quick profit". (*Analysis*, petrs.' brief, pp. 26, 28; *Schedules*, R. 19, 21, sales in September and October.)

Not only did petitioner prove the sales in 1928 in accordance with his intention, but he alleged and respondent admitted that he had the intention throughout the period from 1924 to 1928 of increasing his long account through the process of "pyramiding". (R. 4-5, petition to B. T. A., pars. V-VII. Admitted, R. 21-22.)

The proof of overt acts coupled with proof of intention not only justifies the inference but *compels the conclusion*, in the absence of evidence to the contrary, *that the sales were made in accordance with the intention.* No sane man, under the circumstances, would do anything else than sell the shares, the purchase of which had brought about (following a fall in daily quotations) the necessity of either putting up more margin or reducing the debit balance to less than 70 per cent of the current daily quotations of the shares held in his long account. (Statement of Evidence R. 32) These incidents are common to all speculative margin accounts when the market is active.

Petitioner, might have increased his collateral or reduced the debit balance by payments of cash. He elected, as he had a perfect right to do, to sell shares, even at a loss, in order to apply the proceeds to the reduction of the debit balance.

The evidence is clear and convincing and, being neither impeached nor contradicted, establishes the facts as matter of law under the authorities cited at page 24 of petitioner's brief.

The Statement of Evidence on this point is as follows:

> (R. 31-32) "It was the intention of the petitioner throughout the year 1928 to increase his holdings of shares of the (U. G. I.) stock in his margin accounts with the stock brokers. In each instance of sale of stock on the dates and in the amounts specified in the schedules (R. 18-21)—the respective stock brokers required the petitioner, because of a fall in the market quotations of said U. G. I. stock, either to put up more margin—or to increase his credit balance by selling a sufficient number of shares of the said stock. In *each of such instances petitioner ordered*

said brokers to sell the various amounts of such stock mentioned in said Exhibits B and C (R. 18-21) at the quotations in force on the day of sale, and *in each instance* petitioner had *the intent and purpose of buying back equal or greater amounts of said stock* shortly thereafter. It was not *at any time* the petitioner's intention to sell *any of the shares of stock purchased in prior years,* which showed a large paper profit, but it was his intention in each instance of sale on the dates and in the amounts specified in said Exhibits B and C to sell the last acquired stock, *the purchase of which • • • had brought about an impairment of his margin* below the 30 per cent margin which the brokers required him to maintain."

"Paragraph XIV. All the transactions in the year 1928 of said brokers in the purchase and sale of U.G.I. stock which had the effect of strengthening petitioner's position in the stock market were made for that purpose. • • •"

"Paragraph XIX • • • Throughout 1928 the petitioner did not intend to make any large profits computed by reference to the purchase price in prior years and the sale price of an equal number of shares in 1928. *Nor, if such profits had been made, could they have been withdrawn in cash without impairing petitioner's margin* and thereby necessitating the sale of additional shares."

This evidence is unimpeached and uncontradicted.

The Court of Appeals appears to have overlooked this evidence. Their opinion reads (R. 40):

"He proved what he had thought and *also proved that he had done nothing about it.*"

As pointed out above the evidence shows without impeachment or contradiction that petitioner every time he ordered his brokers to sell intended to sell the stock the purchase of which had brought about the impairment of his margin. In view of the admission that the brokers were under no obligation to sell any specified certificates or

shares, but customarily sold such street certificates as were most conveniently available (R. 10, pet'n to B. T. A., par. XII; admitted, p. 22) a written order to the brokers to sell from any particular lot would have been an idle ceremony; as would have been any book entry or memorandum or declaration, further evidencing petitioner's intent. Any such evidence would have been merely cumulative of petitioner's proved and conceded intent.

On this point the Government and petitioner are in accord.

Respondent states in his brief, page 6:

> "As pointed out in our brief in the Rankin case, since the broker cannot identify the stock sold, it is not apparent how the communication of the taxpayer's intention to the broker can add anything to the intention itself."

THIRD.

THE RESPONDENT HAS NOT CORRECTLY STATED PETITIONER'S POSITION.

At page 7 of the Government's brief in the *Rankin* case it is stated (referring to Sections 111, 112 and 113 of the Revenue Act of 1928, printed in full below, Appendix B, pp. 26-35):

> "The parties here agree that these statutes are applicable."

See further *Ibid*, pp. 2-3, where these sections are quoted in part.

On the contrary, petitioner contends that the applicable statute is comprised in Sections 11, 12, 21, 22 and 23 of the Act, quoted, so far as relevant, in Appendix A, below p. 24.

Respondent contends (*Rankin* brief, p. 28):

> "And it is because of *the very nature of the transaction which makes identification impossible*, that a rule of this kind becomes necessary. The rule is reasonable under the circumstances. It is certainly *the most convenient* from an administrative standpoint. It oper-

ates to the taxpayer's advantage as much as to his disadvantage. Under it he is taxed only on what is his true income. He can offer no better rule."

The fallacy of these contentions is plain. Petitioner, because in 1928 he *was operating in the same stock* which he had accumulated through similar operations in prior years, is taxed $38,961.22. (R. 18) Had his credit balance—his "long" account—been on January 1, 1928, the same in value but in other securities, his tax, even if the regulation were enforced with respect to his sales in that year, would have been but $1897.77 or thereabouts. (Petrs.' brief, Appx. B,* p. 30)

Upon a rising market the enforcement of the regulation increases the tax in this instance more than twenty fold. It can operate to a taxpayer's advantage only on a falling market with which these cases are not concerned.

Can it properly be said that a taxpayer's "true income" in a given tax year is to be measured, not by the result of his active trading operations for that year, but by going back three (or logically twenty) years to ascertain the cost of stock which the taxpayer in the tax year intended to hold for sale in a subsequent year?

As pointed out in petitioner's brief (p. 19) the "long" account to his credit on January 1, 1928, served merely as collateral to enable him to carry on his extensive trading during the year—purchases of 10,600 shares of U. G. L., in 73 transactions, at a cost of ~~$1,095,304.50~~ 4,637.50, sales of 7900 shares in 50 transactions for $1,095,304.50.

Petitioner has and offers a "better rule," namely, that with respect to trading on active margin accounts the year's operations be computed by taking the difference between the purchase price and the sales price of shares bought and sold during the year, deducting expenses, such as commissions, taxes and interest, (under Section 23) and ascertaining whether the result for the year is a profit or a loss. If

*This computation is made without reference to the regulation and without reference to the disallowance of losses on so-called wash sales (Sec. 118, below p. 35 and Sec. 23(e) p. 24). It is our contention that these provisions are inapplicable. This precise point is not here involved.

the sales exceed the purchases, and are not "short" sales, then ascertain what shares on hand the first of the year, the taxpayer intended to sell. This is the method adopted with respect to dealings in other commodities, except where, under Section 22 (c) the inventory basis is used. As noted below (pp. 22-23) the inventory basis is not, under the regulations, used with respect to operators on margin accounts, who, like the petitioner, are officers of corporations.

This Court has held in *Heiner v. Donnan*, 285 U. S. 312, that the difficulty of enforcing the collection of a tax does not justify a statutory presumption, whether conclusive or irrebuttable.

As said by the Supreme Court of Pennsylvania in *L. H. Taylor & Co.'s Assigned Estate*, 192 Pa. 304:

> "Stocks are as legitimate subjects of speculative buying and selling as dry goods or pig iron. A man may buy any commodity, stock included, to sell on an expected rise."

FOURTH.

SECTIONS 111, 112 AND 113 OF THE REVENUE ACT OF 1928, ON WHICH RESPONDENT RELIES, ARE INAPPLICABLE TO TRANSACTIONS OF PURCHASE AND SALE ON MARGIN DURING THE TAX YEAR SUCH AS HERE INVOLVED.

While true that the short excerpts from Sections 111, 112 and 113, quoted at pages 2-3 of the Government's brief in the Rankin case, afford a plausible contention that those sections relate to current transactions of purchase and sale on margin, "trading on the stock exchange," such as are here presented, analysis of these sections shows that they relate to an entirely different subject matter, namely, the sale of property, including securities, held for investment over a period of years, "capital assets".

This Court has recently, in *Helvering v. New York Trust Co.*, 292 U. S. 455, held that the intent of Congress is not to

be ascertained from isolated phrases or paragraphs of a Revenue Act, but that, not only the context, but the Act as a whole must be considered.

The context clearly shows that Sections 111, 112 and 113 relate solely to the sale of property held for investment,—capital assets.

As pointed out in petitioner's brief, page 17, the primary intent of Congress is to require

> "the computation of gains and losses on the basis of an annual accounting *for the transactions of the year*" (*Woolford Realty Co. v. Rose*, 286 U. S. 319, 326, following *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 363).

Sections 111, 112 and 113, must, therefore, be read, as must other detailed provisions, in the light of the controlling provisions of Sections 11, 12, 21, 22 and 23, as construed in the cases last above cited.

It is also to be borne in mind that any doubt as to the construction of the Act is to be resolved in favor of the taxpayer. This point is so well settled that it is not necessary to call attention to any cases in addition to *United States v. Merriam*, 263 U. S. 179.

Sections 11 and 12 provide that normal tax and surtax respectively shall be levied "for each taxable year" equal to the stated percentages of "the net income in excess of credits, etc."; net income is defined by Section 21 as "the gross income computed under Section 22 less the deductions allowed by Section 23. Section 22 defines (by general definition) "gross income" as including "gains, profits and income derived from trades, businesses,—or sales or dealings in property growing out of the use of or interest in such property—or the transaction of any business carried on for profit."

As pointed out in petitioner's brief, pages 16-17, Section 22 is controlled by Section 11 and the phrases "sales or dealings in property" and "transactions entered into for

profit" mean sales *or dealings in property* and transactions, *for each taxable year*. These sections therefore cover the transactions of petitioner and state the basis for computing net taxable income.

With these rules in mind the following analysis of Sections 111, 112 and 113 is submitted. These sections are quoted in full in Appendix B, pages 26-35 below.

Section 111, (a), (b), and (c) (p. 26 below) on which respondent relies, relates to the sale of capital assets or property held for investment, and not to *current purchases and sales* during the tax year of shares of stock or other commodities. Thus subsection (b), (1) and (2), clearly relate to capital assets and authorize the deduction from "the basis provided in section 113" of (1) "any expenditure, receipt, loss or other item, properly chargeable to capital account, (2) that this basis shall be diminished by exhaustion, wear and tear, obsolescence, amortization and depletion which have since the acquisition of the property been allowable under this Act *or prior income tax laws.*" There follows a specific provision that "diminution in respect of depletion" shall not exceed the depletion allowance, under Section 114 (b) (2) for mines discovered *after February 28, 1913*, and, under Section 114 (b) (3), of 27½ per cent of annual gross income derived from oil and gas wells to the extent of 50 per cent of net income.

Obviously, all these extremely detailed provisions relate to physical property, real estate, buildings, machinery, equipment and the like. None of them has any application whatever to marginal transactions in shares of stock.

Coming now to subsection (3) of Section 111 (b) (p. 26 below) we find a specific reference to "stock" which on its face is inapplicable to current transactions of purchase and sale throughout the tax year such as are involved in the instant case.

Subsection (b) (3) reads:

> "*In the case of stock* the basis (as defined in Section 113) shall be diminished by the amount of distributions

previously made in respect of such stock to the extent provided *under the law applicable to the year in which the distribution was made.*"

This specific provision clearly relates only to shares of stock held for investment, or as a capital asset, over a period of years. It has no application on its face to an active trading account on margin with current purchases and sales in the tax year, such as is presented in the instant case.

Reference to the "basis provided in section 113" fortifies and establishes this conclusion.

Section 113 (a) (p. 30 below) reads:

"BASIS FOR DETERMINING GAIN OR LOSS.

"(a) *Property acquired after February 28, 1913*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property."

While, taken literally, (as by the respondent, brief, pp. 2-3; 7-8) this provision might be held applicable to trading on margin and to cover the sales involved in the instant case, the context and the minute and detailed provisions in the twelve numbered paragraphs of subsection (a) clearly show that Congres had in mind (with respect to stock) only shares of stock held for investment—capital assets. There are detailed provisions (pp. 31-35 below) for (1) "INVENTORY VALUE"; (2) "GIFT AFTER DECEMBER 31, 1920"; (3) "TRANSFER IN TRUST AFTER DECEMBER 31, 1920"; (4) "GIFT OR TRANSFER IN TRUST BEFORE JANUARY 1, 1921"; (5) "PROPERTY TRANSMITTED AT DEATH"; (6) "TAX FREE EXCHANGES GENERALLY" (under Section 112); (7) "TRANSFER TO CORPORATION WHERE CONTROL OF PROPERTY REMAINS IN SAME PERSONS": (8) "CORPORATION CONTROLLED BY TRANSFEROR"; (9) "TAX FREE DISTRIBUTIONS" (distributed after December 31, *1923* under Section 112); (10) "INVOLUNTARY CONVERSION" (under Section 112); (11) "WASH SALES OF STOCK";* (12) "PROPERTY ACQUIRED DURING AFFILIATION".

*Sold in prior years, p. 34, *infra*.

Subsection (b) specifically relates to "*Property acquired before March 1, 1913.*"

Section 112 (pp. 27-30 below) provides similarly in great detail for "RECOGNITION OF GAIN OR LOSS." It first lays down a "GENERAL RULE" as follows:

> (a) "Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, shall be recognized, *except as hereinafter provided in this section.*"
>
> "Subsection (b) *Exchanges solely in kind*
>
> (1) PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment,"

Note that the specific reference to "stocks" in this subsection is controlled by the generic sub-title, "Property held for productive use or investment." Hence shares carried on an active margin trading account are not affected.

Then follow detailed provisions under various headings (pp. 27-30 below) numbered from (b) (2) to (b) (5) all clearly relating to capital assets; paragraphs under subsection (c) (1) and (2) "Gain from exchanges not solely in kind," which qualify subsection (b); two paragraphs under subsection (d) "Same—gain of corporation"; (e) "Loss from exchanges not solely in kind," (f) "Involuntary conversions," (g) "Distribution of stock on reorganization," (h) "Same—effect on future distribution," (i) (1) and (2) "Definition of reorganization"; (j) "Definition of control."

Under settled rules of statutory construction these extremely detailed and minute provisions with respect to profit or loss upon the sale or conversion of investment property or capital assets, especially when read in the light of Section 101, relating to "Capital Net Gains and Losses," (giving the taxpayer the option of a special rate of 12½ per cent on gains derived from the sale of "capital assets" held for more than two years) exclude the hypothesis that in enacting those provisions Congress had in mind the sale of shares of stock held in active margin accounts and bought solely (as in the instant case) for trading, as distinguished from investment.

Indeed the Commissioner when he promulgated Article 58 ("first in first out") made it in enlargement or explanation, not of these Sections (111-113) but of Section 22, the definition of "gross income." Articles 561-604, forty-four articles of Regulation 74, relate specifically to Sections 111-113.

It follows that Sections 111-113 are inapplicable to the transactions involved in the instant case, and do not authorize the regulation, here involved, to be applied to the transactions of the petitioner.

FIFTH.

THE REGULATION INVOLVED IS NOT A RULE OF SUBSTANTIVE LAW, BUT, AT MOST, A MERE PRIMA FACIE PRESUMPTION, OR INFERENCE OF FACT, WHICH, BECAUSE OF THE EVIDENCE TO THE CONTRARY, IS AT AN END.

It is idle for respondent to contend (Rankin brief, pp. 23-24) that "the rule here is not so much a rule of evidence as a rule of substantive law." The same contention, with far stronger grounds on which to base it, was made in *Heiner v. Donnan*, 285 U. S. 312. On this point the opinion reads (pp. 328-329):

> "The government makes the point that the conclusive presumption created by the statute is a rule of

substantive law, and regarded as such should be upheld; and decisions tending to supplant that view are cited. The earlier revenue acts created a *prima facie* presumption, which was made irrebuttable by the later act of 1926. *A rebuttable presumption clearly is a rule of evidence* which has the effect of shifting the burden of proof, *Mobile, J. & K. R. Co. v. Turnipseed*, 219 U. S. 35, 43; and it is hard to see how a statutory rebuttable presumption is *turned from a rule of evidence into a rule of substantive law* as the result of a later statute making it conclusive."

The Court then cites *Schlesinger v. Wisconsin*, 270 U. S. 230; *Bailey v. Alabama*, 219 U. S. 219, 238, and *Manley v. Georgia*, 279 U. S. 1, 5-6, from which last case an excerpt is quoted, and continues (p. 329):

> "If a legislative body is without power to enact as a rule of evidence a statute denying a litigant the right to prove the facts of his case, certainly the power cannot be made to emerge by putting the enactment in the guise of a rule of substantive law."

See further to same effect *United States v. Provident Trust Co.*, 191 U. S. 272, 283.

Respondent takes two inconsistent positions.

First (p. 22, Rankin brief):

> "But in marginal transactions, particularly in pyramiding operations such as those in the Snyder case, it is *impossible* for the taxpayer to identify. In such cases the need for such a rule as this seems apparent."

Upon this premise respondent bases the wholly unwarranted conclusion, directly contrary to the considered opinion of this Court in *Heiner v. Donnan*, that the regulation is valid as a rule of substantive law (Ibid, p. 23) analogous to the *conclusive presumptions of law* with regard to the age of an infant, etc., etc. (Ibid pp. 24-25).

Second (Ibid p. 27):

> "The taxpayer is given *every opportunity to identify the shares he has sold* and to prove his gain or loss accordingly. The regulation does not deny the taxpayer a fair opportunity to offer testimony as in *Bailey v. Alabama, supra,* and *Manley v. Georgia, supra.*"

Respondent then quotes an excerpt from *Mobile etc. R. R. v. Turnipseed,* 219 U. S. 35, 43 (included in the quotation from *Bailey v. Alabama,* 219 U. S. 219, 238, at page 23 of petitioner's brief), but fails to quote the preceding portion of the opinion quoted in full in petitioner's brief, page 25, that when "some evidence to the contrary" of the inference of fact raised by the presumption is introduced, "the inference is at an end."

In respondent's brief, pp. 24, 25, there are references to Chamberlayne on Evidence and Wigmore on Evidence. All of the "conclusive presumptions" there referred to are not presumptions, or statutory inferences, of fact but presumptions of law. In other words, they are provisions of substantive law and not rules of evidence. Under this classification are included the rules with regard to the age of a child at which a criminal intent can be formed, the age at which certain crimes may be committed and consent given. So, with regard to the effect of tax deeds, deeds registered a certain number of years, the citizenship of stockholders of a corporation. The statutory imposition of liability on cities for damages by mob violence is, of course, not a rule of evidence at all.

Atlantic Coast Line v. Riverside Mills, 219 U. S. 186, cited at page 24, does not relate to an inference of fact, but to a rule of substantive law, namely, that the initial carrier should be liable for loss or damage to goods shipped on a through bill of lading over the lines of connecting carriers. The statute (Carmack Amendment) was sustained

on the theory that it made the initial carrier the principal contractor, and the connecting carriers its agents (p. 206). There was no question raised as to presumptions of law or of fact. The only question was as to the power of Congress to prohibit the initial carrier from limiting its contractual liability to carriage over its own lines.

The statutory presumption that dividends are presumed to have been paid out of past accumulated profits or surplus, is a rule of substantive law, enacted in order to avoid the question of constitutionality which would arise with regard to the power of Congress to tax dividends paid out of surplus accumulated prior to the adoption of the Sixteenth Amendment. See *Helvering v. Canfield*, 291 U. S. 163, p. 19 below.

The regulation clearly raises an inference of fact and nothing more. It reads:

> "When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined"

That is to say cannot be proved *by evidence*,

> "the stock sold shall be charged against the earliest purchases of said stock."

In other words when the taxpayer fails to show by some form of identification which shares are sold *the fact* is presumed, or inferred, that the shares sold are those earliest purchased.

This Court has held in *Mobile etc. R. R. v. Turnipseed*, 219 U. S. 35, that when evidence to the contrary of such an inference is introduced "the inference is at an end" (quoted Petrs. brief, p. 25).

Respondent cites, as noted above, 5 Wigmore on Evidence 2d Ed. Sec. 2492 (brief pp. 23-24), upon the entirely unsound contention that the regulation establishes a *conclusive presumption of law* or a rule of substantive law.

That author states at the immediately preceding section, 2491 (Vol. 5, p. 452) the rule with regard to presumptions or inferences of fact, substantially as in the cited excerpt from the *Mobile-Turnipseed* case, as follows:

> "It is therefore *a fallacy* to attribute • • • an artificial probative force to a presumption, *increasing* for the jury *the weight of the facts,* even when the opponent has come forward with *some* evidence to the contrary. For example, if death be the issue, and the fact of absence for seven years unheard of be conceded, but the opponent offers evidence that the absentee, before leaving, *proclaimed his intention* of staying away for ten years, until a prosecution for crime was barred, this satisfies the opponent's duty of producing evidence, *removing the rule of law;* and, when the case goes to the jury, they are at liberty to give *any probative force they think fit* to the fact of absence for seven years unheard from. *It is not weighed down with any artificial additional probative effect.* • • •"

See also to same effect, Jones on Evidence in Civil Cases, 3rd Ed. Sec. 104.

See also *Sweeney v. Erving,* 228 U. S. 233, 240, 241, *res ipsa loquitur* rule.

It follows that, assuming that the regulation is applicable to the instant case, it raises a mere inference of fact. Evidence to the contrary having been introduced, the inference is at an end. This evidence being unimpeached and uncontradicted the fact is established that the last acquired stock was sold in each instance. Hence the tax should be recomputed and the court below erred in sustaining the Board of Tax Appeals.

SIXTH,

THE REGULATION INVOLVED, IF APPLICABLE, IS CONCEDEDLY IRREBUTTABLE, WITH RESPECT TO THE IDENTIFICATION OF SHARES OF STOCK, IN THE FORM OF STREET CERTIFICATES CARRIED IN A MARGIN ACCOUNT, AND THEREFORE AD HOC BEYOND THE POWER OF THE COMMISSIONER.

Respondent contends (Rankin brief, pp. 23-26), that the regulation is conclusive, in other words irrebuttable. This point is discussed fully in petitioner's brief, pages 21-23. We shall confine ourselves in this reply brief to a discussion of certain of the cases cited by respondent (Ibid), namely, those decided by this Court. The other cases cited are either of the Circuit Courts of Appeals or of State courts. Except for *Howbert v. Penrose*, 38 Fed. 2d 577, 578, cited under petitioner's Sixth Point (brief pp. 23-24), which is directly in petitioner's favor, they differ so greatly on the facts, as not to require detailed discussion.

Burnet v. Houston, 283 U. S. 223, is not in point. The question was as to value of property acquired before March 1, 1913, sold at a loss thereafter. The taxpayer did not attempt to prove value on March 1, 1913, so the deduction of the loss was not allowed.

In *Reaves v. Ainsworth*, 219 U. S. 296, 304, the only question involved was as to whether the decision of a military tribunal constituted due process of law. No presumption was involved.

In *Hagar v. Reclamation District*, 111 U. S. 701, 708, the only question involved was as to whether a State statute complied with the due process clause of the Fourteenth Amendment by granting a hearing with respect to an assessment upon land within a reclamation district. No presumption was involved.

In *Helvering v. Canfield*, 291 U. S. 163, the statute (Revenue Act 1921, par. 201, 42 Stat. 228) provided that distributions to stockholders out of accumulated earnings and profits should be (for the purposes of the Act) out of

profits accumulated after February 28, 1913, and should be taxable, but that distributions from profits, etc., accumulated prior to that date should be exempt. *The only question involved* was as to whether losses in 1915, 1916, should be deducted from the surplus of February 28, 1913, or from subsequent profits. It was held that they should be deducted from the surplus of February 28, 1913.

The statute requiring the distributions to be deemed to have been made out of the later profits was a rule of substantive law. No question of the constitutional validity of any presumption or rule of evidence was involved.

In *Mason v. Routzahn*, 275 U. S. 175, the statute (Revenue Act of October 3, 1917, C. 63 Title XII, 40 Stat. 300, 338), provided that any distribution to stockholders in 1917 or later years should be deemed to have been made from the most recently accumulated undivided profits and taxed at the rate in force *in the year when accumulated*. Mason, a shareholder in the Goodrich company, received five dividends in 1917, all of which were paid out of profits accumulated in 1916. Two of these dividends were declared in 1916. At the time the three others were declared in 1917 there were no net profits for that year, applicable to payment of dividends. It was held, sustaining the District Court, and reversing the Circuit Court of Appeals, that all five dividends were taxable at the 1916 rate. No constitutional question was involved.

Orient Insurance Co. v. Daggs, 172 U. S. 557, 566, turns on the power of a State to prescribe the terms of fire insurance policies. The theory that the statute established a conclusive, or any presumption was rejected (p. 566).

In *MacLaughlin v. Alliance Insurance Co.*, 286 U. S. 244 (cited in respondent's brief in this case p. 9), the question presented related to the gain realized on the sale, in 1928, of securities held *as an investment* for upwards of fifteen years. The rule of "first in first out" was not in anyway involved or discussed.

The two following cases cited by the respondent state clearly the relations between stock brokers and their customers.

In *Gorman v. Littlefield,* 229 U. S. 19, 24, the statement of the relations between stockbrokers and their customers is quoted from *Saxton v. Kessler,* 225 U. S. 90, substantially as stated in the petition in the instant case and admitted (R. 5-11, 21-22) and the opinion continues (p. 24):

> "It is therefore unnecessary for a customer, where shares of stock of the same kind are in the hands of a broker, being held to satisfy his claims, to be able to put his finger upon the identical certificates of stock purchased for him. It is enough that the broker has shares of the same kind which *are legally subject to the demand of the customer* (p. 25) * * *. It was, as we have seen, the duty of the broker, if he sold the shares specifically purchased for the appellant, to buy others of like kind and to keep on hand, subject to the order of the customer, certificates sufficient for the legitimate demands upon him. If he did this, the identification of particular certificates is unimportant."

On this point see the admitted allegations in the petition to the Board of Tax Appeals (R. 11, par. XIII).

In *Duel v. Hollins,* 241 U. S. 523, 529, it was held, following *Gorman v. Littlefield,* that where certificates of a certain stock were found in the box of a bankrupt broker, but for a less number of shares than had been bought for the account of a number of customers, the shares so found should be divided pro rata.

It follows that the cases cited by the respondent do not sustain the Government's contention.

SEVENTH.

SHOULD IT BE HELD THAT THE REGULATION IS VALID AND ENFORCEABLE WITH RESPECT TO TRANSACTIONS OF PURCHASE AND SALE ON MARGIN, IT SHOULD BE LIMITED IN ITS APPLICATION TO THE INSTANT CASE, TO THE PURCHASES IN THE TAX YEAR AND NOT APPLIED TO PURCHASES IN PRIOR YEARS.

If this Court should sustain the regulation against the evidence and further sustain petitioner's contention that (as the purchases exceeded the sales in the tax year), the transactions in 1928 should be segregated and used as the basis for computation, without regard to purchases in prior years, the tax might be increased beyond that computed in Appendix B to petitioner's brief, page 30, but would be far less than the tax assessed* (R. 18).

The purchases on hand exceeded the sales throughout the year, except for the sale of 700 shares in February, bought back in March (*Schedules*, R. 18, 20).

The great difficulty of computing the taxable income without the regulation, on which respondent lays such stress (p. 28) does not exist in the instant case and no reason is perceived justifying the conclusion that in similar cases of marginal trading there should be any serious difficulty if the regulation is held inapplicable.

The basis of computation by inventories (Sec. 22 (c)) is inadmissible. The Commissioner, by Article 105 of Regulations 74, expressly eliminated:

> "Taxpayers *who buy and sell* or hold *securities for* investment or *speculation* and not in the course of an established business and officers of corporations (such as petitioner R. 21, par. V) who in their individual capacities buy and sell securities"

from the class of dealers in securities who may make their returns on the inventory basis.

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*See footnote, p. 8 *supra*.

CONCLUSION.

The judgment below should be reversed and the cause remanded with instructions to recompute the tax in accordance with the views above expressed.

March 11, 1935.

HENRY M. WARD,
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APPENDIX A

REVENUE ACT OF 1928, SECTIONS 11, 12, 21, 22, 23, AS FAR AS RELEVANT (43 Stat. 791, 795 etc. C. 852)

"Sec. 11. NORMAL TAX ON INDIVIDUALS. (45 Stat. 795) There shall be levied, collected and paid *for each taxable year* a normal tax equal to the sum of the following:

"(a) 1½ per centum of the first $4,000 of the amount of the net income in excess of the credits against net income provided in section 25," etc., etc.

"Sec. 12. SURTAX ON INDIVIDUALS. (Ibid, 796) (a) *Rates of surtax*—There shall be levied, collected, and paid *for each taxable year upon the net income* of every individual a surtax as follows:" etc., etc.

"Sec. 21 (Ibid, 797) NET INCOME.

"Net income 'means the gross income computed under Section 22, *less the deductions allowed by Section 23.*'

"Sec. 22. (Ibid) GROSS INCOME.

"(a) *General definition.* 'Gross income' includes gains, profits and income derived from * * * trades, businesses, * * * or sales, or dealings in property whether real or personal * * * growing out of the ownership or use of or interest in such property; * * * or *the transaction of any business carried on for gain or profit* or gains or profits and income derived from any source whatever.

"Sec. 23. DEDUCTIONS FROM GROSS INCOME. (Ibid, 799) In computing net income there shall be allowed as deductions:

"(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred *during the taxable year* in carrying on any trade or business. * * *

"(b) *Interest*—All interest paid or accrued *within the taxable year* on indebtedness. * * *

"(c) *Taxes generally*—Taxes paid or accrued *within the taxable year.*

"(e) *Losses by Individuals.* In the case of an individual, *losses, sustained during the taxable year* and not compensated for by insurance or otherwise.

"(1) if incurred in trade or business; or

"(2) if incurred *in any transaction entered into for profit,* though not connected with any trade or business."

"(g) *Basis for determining loss*—The basis *for determining the amount of deduction for losses* sustained, to be allowed under *subsection* (e) or (f),* shall be the same as is provided by section 113 *for determining the gain or loss* from the sale or other disposition of property.

"(h) *Loss on sale of stock or securities*—For disallowance of loss deduction in the case of sales of stock or securities where within thirty days before or after the date of the sale the taxpayer has acquired substantially identical property, see Section 118."

Note. While it is provided that *losses,* generally, shall be determined on the basis stated in Section 113 and reference is made with respect to "loss on sale of stock", in Section 118, there is no provision that *profits* or gains shall be computed under these sections.

*Subsection (f) relates to corporations only.

APPENDIX B.

REVENUE ACT OF 1928, C. 852, 45 Stat. 791, 815, 818.

SUPPLEMENT B—COMPUTATION OF NET INCOME.
[Supplementary to Subtitle B, Part II]

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(b) *Adjustment of basis.*—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item, properly chargeable to capital account, and

(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws; but in no case shall the amount of the diminution in respect of depletion exceed a depletion deduction computed without reference to discovery value under section 114 (b) (2) or to percentage depletion under section 114 (b) (3). In addition, if the property was acquired before March 1, 1913, the basis (if other than the fair market value as of March 1, 1913) shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before such date, and

(3) In the case of stock the basis shall be diminished by the amount of distributions previously made in respect of such stock, to the extent provided under the law applicable to the year in which the distribution was made.

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

Sec. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

(1) PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT.—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) STOCK FOR STOCK OF SAME CORPORATION.—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a re-

organization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(f) *Involuntary conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

(g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corpration a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(h) *Same—effect on future distributions.*—The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining the taxability of subsequent distributions by the corporation.

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

(1) INVENTORY VALUE.—If the property should have been included in the last inventory, the basis shall be the last inventory value thereof;

(2) GIFT AFTER DECEMBER 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) TRANSFER IN TRUST AFTER DECEMBER 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made;

(4) GIFT OR TRANSFER IN TRUST BEFORE JANUARY 1, 1921.—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in section 402 (e) of the Revenue Act of 1921, or in section 302 (f) of the Revenue Act of 1924 or the Revenue Act of 1926 (relating to property passing under the power of appointment) regardless of the time of acquisition;

(5) PROPERTY TRANSMITTED AT DEATH.—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the de-

cedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death;

(6) TAX-FREE EXCHANGES GENERALLY.—If the property was acquired upon an exchange described in section 112(b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

(7) TRANSFERS TO CORPORATION WHERE CONTROL OF PROPERTY REMAINS IN SAME PERSONS.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such prop-

erty of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer;

(8) SAME—CORPORATION CONTROLLED BY TRANSFEROR.—If the property was acquired after December 31, 1920, by a corporation by the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;

(9) TAX-FREE DISTRIBUTIONS.—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112(g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

(10) INVOLUNTARY CONVERSION.—If the property was acquired as the result of a compulsory or involuntary conversion described in section 112(f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable

status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made;

(11) WASH SALES OF STOCK.—If substantially identical property was acquired after December 31, 1920, in place of stock or securities which were sold or disposed of and in respect of which loss was not allowed as a deduction under section 118 of this Act, or under section 214(a)(5) or 234(a)(4) of the Revenue Act of 1921, the Revenue Act of 1924, or the Revenue Act of 1926, the basis in the case of the property so acquired shall be the basis in the case of the stock or securities so sold or disposed of, except that if the repurchase price was in excess of the sale price such basis shall be increased in the amount of the difference, or if the repurchase price was less than the sale price such basis shall be decreased in the amount of the difference;

(12) PROPERTY ACQUIRED DURING AFFILIATION.—In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to intercompany transactions in respect of which gain or loss was not recognized. For the purposes of this paragraph, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928. The basis in case of property acquired by a corporation during any period, in the taxable year 1929 or an subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this Act, shall be determined in accordance with regulations prescribed under section 141 (b).

(b) *Property acquired before March* 1, 1913.—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a)(1), (4), (5), or (12) of this section, the basis as therein provided), or

(2)the fair market value of such property as of March 1, 1913,

whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

SEC. 118. LOSS ON SALE OF STOCK OR SECURITIES.

In the case of any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition, no deduction for the loss shall be allowed under section 23(e)(2) of this title; nor shall such deduction be allowed under section 23(f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed.